

## **FISCAL NOTE**

### **SB 93 – HB 114**

February 5, 2007

**SUMMARY OF BILL:** Enacts the “Food Tax – Cigarette Tax Swap Act of 2007.” Reduces the state sales tax rate on food sales from 6% to 3%. Increases the excise tax on cigarettes from 20 cents to 64 cents per pack. Increases the excise tax on cigarettes by 1 cent per pack each fiscal year beginning with FY08-09 and continuing until FY17-18.

#### **ESTIMATED FISCAL IMPACT:**

**Increase State Revenues – Net Impact - \$86,371,000 / Education Fund**

**Decrease State Revenues – Net Impact -**

**\$67,614,000 / General Fund**

**\$11,223,000 / Earmarked to Local Governments**

**\$856,000 / Department of Revenue**

**\$2,140,000 / Sinking Fund**

**Increase State Expenditures – \$11,223,000 / General Fund**

**\$220,000 / Department of Revenue - Recurring**

**\$200,000 / Department of Revenue - One-Time**

**Increase Local Govt. Revenues – Net Impact - \$4,199,000 Recurring**

#### **Food Tax Assumptions:**

- According to the Department of Revenue, taxable sales of food and food ingredients in Tennessee for FY05-06 were approximately \$7,753,600,000.
- Based on historical collection patterns, taxable sales of food and food ingredients are estimated to grow by approximately 2.5% per year.
- Taxable sales for FY07-08 are estimated to be approximately \$8,146,126,000.
- The recurring decrease in state sales tax revenue resulting from a one-time 3% rate reduction for food sales is estimated to be \$244,384,000 ( $\$8,146,126,000 \times 3\% = \$244,383,780$ ) per year.

- The estimated \$244,384,000 in state sales tax revenue would have been apportioned as follows: \$70,931,000 to the General Fund, \$159,087,000 to education, \$11,223,000 to local governments, \$898,000 to the Department of Revenue (DOR), and \$2,245,000 to the Sinking Fund.
- The state will forgo additional sales tax revenue in subsequent fiscal years due to growth of taxable sales.
- Local governments are held harmless from the loss of state-shared sales tax revenue.
- The increase to state expenditures for holding local governments harmless is estimated to be \$11,223,000.
- Payments are made to local governments from the General Fund.

#### Cigarette Tax Assumptions:

- According to the DOR, excise tax collections on cigarettes in FY05-06 were approximately \$115,462,000.
- Current excise tax rate on cigarettes is \$0.20 per pack.
- Estimated number of packs sold in FY05-06 was 577,310,000 ( $\$115,462,000 \div \$0.20 = 577,310,000$  packs).
- Cigarette elasticity is estimated from a variable elasticity schedule depending upon the extent of any excise tax increase.
- Cigarette elasticity rate for proposed increase is estimated to be -0.315.
- Current state sales tax rate on cigarettes is 7.00%.
- Local option sales tax rate on cigarettes is estimated to be 2.25%.
- Current consumer price per pack is estimated to be \$3.19 per pack (excluding sales tax); \$3.49 per pack (including sales tax).
- Increasing the excise tax on cigarettes by \$0.44 per pack would also generate an additional \$0.04 per pack in state and local option sales tax revenue ( $\$0.44 \times 9.25\% = \$0.041$ ).
- The total price increase to the consumer is estimated to be \$0.48 per pack ( $\$0.44$  excise tax increase +  $\$0.04$  incremental sales tax =  $\$0.48$ ).
- Consumer price per pack after the proposed excise tax increase is estimated to be \$3.63 per pack (excluding sales tax); \$3.97 per pack (including sales tax).
- Increasing the excise tax on cigarettes would increase the price per pack to the consumer by an estimated 13.75% ( $\$0.48 \div \$3.49 = 13.75\%$ ).
- Quantity demanded would decrease by an estimated 4.33% ( $13.75\%$  price increase  $\times -0.315$  elasticity rate =  $-4.33\%$ ).
- Quantity demanded in FY07-08 is estimated to be 552,312,500 packs ( $577,310,000 \times \{100.00\% - 4.33\%\} = 552,312,477$ ).
- Total excise tax collections are estimated to be \$353,480,000 ( $552,312,500$  packs  $\times \$0.64$  excise tax =  $\$353,480,000$ ) in FY07-08.

- Incremental excise tax collections are estimated to be \$238,018,000 ( $\$353,480,000 - \$115,462,000 = \$238,018,000$ ) per year.
- 100% of the estimated \$238,018,000 in incremental excise tax collections would be apportioned exclusively for public education, grades one through twelve.
- Excise tax collections would grow in subsequent fiscal years due to the additional excise tax rate increases proposed in this legislation.
- Sales tax collections will increase because sales tax is computed on the final retail sale (which includes any current and increased excise tax).
- Retail sales before the proposed excise tax increase are estimated to be \$1,841,619,000 ( $577,310,000 \text{ packs} \times \$3.19 \text{ old price (excluding sales tax)} = \$1,841,618,900$ ).
- Retail sales after the proposed excise tax increase are estimated to be \$2,004,894,000 ( $552,312,500 \text{ packs} \times \$3.63 \text{ new price (excluding sales tax)} = \$2,004,894,375$ ).
- Incremental retail sales are estimated to be \$163,275,000 ( $\$2,004,894,000 - \$1,841,619,000 = \$163,275,000$ ).
- Incremental state sales tax revenue is estimated to be \$11,429,000 ( $\$163,275,000 \times 7.00\% \text{ state rate} = \$11,429,250$ ) per year.
- The \$11,429,000 in incremental state sales tax revenue would be apportioned as follows: \$3,317,000 to the General Fund, \$7,440,000 to education, \$525,000 to local governments, \$42,000 to the DOR, and \$105,000 to the Sinking Fund.
- The net recurring increase to state revenues resulting from incremental state sales tax collections is estimated to be \$10,904,000 ( $\$11,429,000 - \$525,000 \text{ local share} = \$10,904,000$ ) per year.
- Additional sales tax revenue will result (for both state and local governments) in subsequent fiscal years due to the additional excise tax rate increases proposed in this legislation.
- The total net recurring increase to state revenues resulting from the increased excise tax is estimated to be \$248,922,000 ( $\$238,018,000 \text{ from additional excise tax} + \$10,904,000 \text{ from additional sales tax} = \$248,922,000$ ) per year.
- Incremental local option sales tax revenue is estimated to be \$3,674,000 ( $\$163,275,000 \times 2.25\% \text{ local option rate} = \$3,673,688$ ).
- The total net recurring increase to local government revenues resulting from the increased excise tax is estimated to be \$4,199,000 ( $\$3,674,000 \text{ in local option tax revenue} + \$525,000 \text{ in state-shared sales tax revenue} = \$4,199,000$ ).

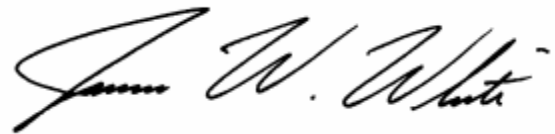
#### Other Assumptions:

- The legislative intent of this act is that the fiscal impact of this bill be at least revenue-neutral.

- Three additional Regulatory Officers in the DOR will be required to combat the illegal importation of cigarettes into Tennessee.
- Security upgrades will be required for cigarette tax stamps to combat illegal/counterfeit tax stamps.
- The recurring increase to state expenditures for the new positions and tax stamp enhancements is estimated to be \$220,000 per year.
- The one-time increase to state expenditures for computer and software enhancements and for costs associated with hiring the three Regulatory Officers is estimated to be \$200,000.
- The total net recurring decrease to state revenues resulting from this proposed legislation is estimated to be \$7,105,000 (\$248,922,000 increase generated from additional excise tax on cigarettes - \$244,384,000 decrease from lower sales tax revenue on food sales - \$11,223,000 in continued payments to local governments [per hold-harmless provision] - \$420,000 one-time/recurring expenditures = total net decrease of \$7,105,000) per year.
- An excise tax equal to 66 cents per pack (or 3.3 cents per cigarette) in FY07-08, instead of the 64 cents per pack as proposed (or 3.2 cents per cigarette), would be necessary to achieve the revenue-neutral intent stated in Section 5 of this legislation.
- The incremental excise tax revenue generated from subsequent one-cent increases is sufficient to offset any incremental decrease of state sales tax revenue that would have occurred from growth of taxable food sales.

### **CERTIFICATION:**

This is to duly certify that the information contained herein is true and correct to the best of my knowledge.



James W. White, Executive Director